(b)

Office - Supreme Court, U. S.
FILED
APR 3 1943
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1942.

No. 880.

THE AETNA CASUALTY AND SURETY COMPANY,
Petitioner,

v.

FIRST CAMDEN NATIONAL BANK AND TRUST COMPANY,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOSEPH W. HENDERSON,
Attorney for Petitioner.

GEORGE M. BRODHEAD, JR.,
Of Counsel.

International, 236 Chestnut St., Philadelphia



TABLE OF CONTENTS OF PETITION.

	Page
Summary and Statement of Matter Involved.....	1
Jurisdiction	7
Opinions	8
Questions Presented	8
Reasons for Granting the Petition	9

CASES CITED IN PETITION.

	Page
Board of County Commissioners of the County of Jackson, Kansas v. United States, 308 U. S. 343 (1939)	9
Deitrick, Receiver v. Greaney, 309 U. S. 190 (1940)	9
D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation, 315 U. S. 447 (1942)	9
R. P. Farnsworth & Co., Inc. v. Electrical Supply Co., 112 F. (2d) 150 (C. C. A. 5th, 1940)	10
Grover v. Board of Education of Township of Franklin, 102 N. J. E. 415, 141 Atl. 81 (1928) affd. in 104 N. J. E. 197, 144 Atl. 918 (1929)	6
Henningsen v. United States Fidelity & Guaranty Co., 208 U. S. 404 (1908)	10
Martin v. National Surety Co., 300 U. S. 588 (1937)	10
Morley Construction Co. v. Maryland Casualty Co., 300 U. S. 185 (1937)	10
O'Brien v. Western Union Telegraph Co., 113 F. (2d) 539 (C. C. A. 1st, 1940)	10
Prairie State Bank v. United States, 164 U. S. 227 (1896)	10
Royal Indemnity Co. v. United States, 313 U. S. 289 (1941)	9
United States v. Johnson, Smathers & Rollins, 67 F. (2d) 121 (C. C. A. 4th, 1933)	10
Walker v. Brown, 165 U. S. 654 (1897)	10

STATUTES CITED IN PETITION.

	Page
Act of February 13, 1925, c. 229, § 1, 43 Stat. 928 (28 U. S. C. A. § 347 (a))	8
Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270)	2, 8, 10, 11
Miller Act (49 Stat. 793, 40 U. S. C. A. § 270a)	2, 11
R. S. New Jersey 2:60-212 (1932)	6, 11

TABLE OF CONTENTS OF BRIEF.

	Page
Summary of Argument	13
Argument	14
I. The Provision in Petitioner's Letter of Guaranty Placing the Situs in New Jersey for Purposes of Construction Does Not Constitute an Agreement That New Jersey Law Should Govern the Question Whether Petitioner's Undertaking Thereunder Had Subsequently Been Paid	14
II. Federal Law Governs the Right of Respondent to Apply Federal Funds Received From Federal Contractor, With Knowledge of Their Source, in Payment of a Debt Unrelated to the Federal Contract Instead of Applying the Funds to the Payment of Bills for Labor and Materials Incurred on the Federal Contract	16
III. Under Federal Law the Respondent Was Bound to Apply the $20,500.00 on Account of the Claims for Labor and Materials Covered in the Letter of Guaranty and Not to the Payment of a Debt Unrelated to It	19
IV. Under the Law of the State of New Jersey the Respondent Was Bound to Have Applied the $20,500.00 on Account of the Claims for Labor and Materials Specified in the Letter of Guaranty	21
Conclusion	23

CASES CITED IN BRIEF.

Page

Board of County Commissioners of the County of Jackson, Kansas v. United States, 308 U. S. 343 (1939) 17

Clearfield Trust Company v. United States, — U. S. —, 63 Sup. Ct. 573 (decided March 1, 1943) 17, 18

Deitrick, Receiver v. Greaney, 309 U. S. 190 (1940) .. 17

Erie Railroad Co. v. Tompkins, 304 U. S. 64 (1938).. 19

R. P. Farnsworth & Co., Inc. v. Electrical Supply Co., 112 F. (2d) 150 (C. C. A. 5th, 1940) 17, 19, 20

Grover v. Board of Education of Township of Franklin, 102 N. J. E. 415, 141 Atl. 81 (1928), affirmed in 104 N. J. E. 197, 144 Atl. 918 (1929)....21, 22, 23

Henningsen v. United States Fidelity and Guaranty Co., 208 U. S. 404 (908) 20

Martin v. National Surety Co., 300 U. S. 588 (1937).. 20

Morley Construction Co. v. Maryland Casualty Co., 300 U. S. 185 (1937) 20

O'Brien v. Western Union Telegraph Co., 113 F. (2d) 539 (C. C. A. 1st, 1940) 17

Prairie State Bank v. United States, 164 U. S. 227 (1896) 20

Royal Indemnity Co. v. United States, 313 U. S. 289 (1941) 17

Sola Electric Co. v. Jefferson Electric Co., — U. S. —, 63 Sup. Ct. 172 (decided Dec. 7, 1942)..... 19

United States v. Clearfield Trust Co., 130 F. (2d) 93, 95 (C. C. A. 3rd, 1942) 18

United States v. Hutcheson, 312 U. S. 219, 235 (1941) 23

United States v. Johnson, Smathers & Rollins, 67 F. (2d) 121 (C. C. A. 4th, 1933) 19

Walker v. Brown, 165 U. S. 654 (1897) 20

STATUTES CITED IN BRIEF.

	Page
Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270)	14, 17, 18
Miller Act (49 Stat. 793; 40 U. S. C. A. § 270 a, b, c, and d)	18
R. S. New Jersey 2:60-212 (1932)	22

IN THE

Supreme Court of the United States.

No. . October Term, 1942.

THE AETNA CASUALTY AND SURETY COMPANY,
Petitioner,

v.

FIRST CAMDEN NATIONAL BANK AND TRUST COMPANY,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, The Aetna Casualty and Surety Company, prays that a writ of certiorari be issued to review the final judgment of the United States Circuit Court of Appeals for the Third Circuit, entered on December 4, 1942, (R. 161), rehearing denied January 8, 1943 (R. 169), which judgment affirmed a final judgment of the District Court of the United States for the District of New Jersey, entered in favor of respondent and against the petitioner in the sum of $20,500.00.

SUMMARY AND STATEMENT OF MATTER INVOLVED.

A civil action was instituted by the respondent in the District Court of the United States for the District of New Jersey to recover from petitioner the sum of $20,500.00 under the terms of a written undertaking or guaranty con-

tained in a letter dated February 23, 1937 (R. 3-9, 120), which is set forth in succeeding paragraphs.

Petitioner was surety on a bond running to the United States taken pursuant to the provisions of the Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270), which has since been replaced by the Miller Act (49 Stat. 793, 40 U. S. C. A. § 270a). The bond, in accordance with the statute, guaranteed the faithful performance of the contract and the payment of labor and material bills. Certain labor and material bills were incurred which the contractor was unable to pay as they became due and for which the petitioner was ultimately liable under its bond. By the aforesaid letter to respondent (R. 6-8) petitioner (a) approved the correctness of a list of bills therein set forth and admitted its liability for their payment; (b) guaranteed that, if respondent took assignments of the bills listed, the petitioner would recognize each assignment and pay the bill evidenced thereby within six months after the final settlement of the construction contract, or at all events not later than February 23, 1938; and (c) stated that "the situs of this guaranty is New Jersey and shall be construed under the laws of said state." The letter in full is as follows, excepting only the list of the claimants and their bills:

"THE AETNA CASUALTY AND SURETY COMPANY
HARTFORD, CONNECTICUT

Fidelity and Surety Claim
Department February 23, 1937

First Camden National Bank & Trust Company,
Camden, N. J.

Re: S-18577—William Eisenberg & Sons, Inc.

Gentlemen:

Heretofore, on or about the 6th day of March, 1935 the Aetna Casualty & Surety Company, as surety, ex-

ecuted a contract bond running to the United States of America in the amount of $412,757.07, which said bond, in accordance with the provisions of the Hurd Act (40USCA270) guaranteed the faithful performance by William Eisenberg & Sons, Inc. of a contract with the Government for the construction of a dam at Beach City, Ohio, and payment of all bills for labor and materials incurred in connection therewith. We are informed that the value of work done to date under this contract amounts to approximately $660,251.58, and that the contractor has already received payments of $616,745.82, leaving retained percentage 'earned' in the approximate amount of $43,000.20.

It appears that the contractor is heavily indebted for labor and material bills, and while the responsibility of the Aetna as surety for the actual payment of such bills does not accrue until six months after the final settlement of the contract, its liability for this eventual payment is nevertheless fixed and definite for all labor and material bills which may be shown to have been incurred in connection with the project.

The contractor has informed us that he desires to borrow from you the sum of $30,000 to be used for the sole purpose of paying the following bills for material and labor incurred in the project above mentioned:

. . . . .

(next follows a list of the claimants and the amounts of their respective bills, the total of which amounts to $29,912.36)

. . . . .

We are further informed that you will take as security for this loan an assignment from each material and labor claimant of all of his rights of every description against this Company on the aforesaid bond executed for William Eisenberg & Sons, Inc. Being de-

sirous of assisting the contractor in procuring such loan, and in consideration of your making such loan to them, and as an inducement to you so to do, it is hereby agreed as follows:

(1) We affirm our aforesaid bond to be a valid and subsisting obligation, and further affirm that it is unqualifiedly liable for the bills hereinbefore listed in the amounts indicated above, and we hereby estop ourselves from denying the fact in any court to your prejudice.

(2) If you take assignments of such bills, and claims, on a form similar to the one attached hereto, or on any other appropriate form, we hereby agree to recognize such assignment to the fullest extent, and agree to pay the bill evidenced thereby, without interest, however, or so much thereof as remains unpaid at the expiration of six months subsequent to the final settlement of the foregoing construction contract at all event, not later than one year from February 23, 1937.

The situs of this guaranty is New Jersey and shall be construed under the laws of said State.

Trusting this is satisfactory, we are,

Yours very truly

THE AETNA CASUALTY AND SURETY COMPANY

By WILMOT SMITH
Vice-President

Attest A. R. Sexton
Secretary

CC Thomas J. Marshall, Attorney
Philadelphia, Pa.
William Eisenberg & Sons, Inc.
Camden, N. J."

(R 6-8.)

In reliance upon the said letter, the respondent lent to the contractor, the principal in petitioner's bond, the sum of Twenty Nine Thousand Nine Hundred Twelve Dollars and Thirty Six Cents ($29,912.36) and took assignments of the bills listed in the letter aggregating that amount (R. 122). In due course, the petitioner paid the respondent Nine Thousand Four Hundred Twelve Dollars and Thirty Six Cents ($9,412.36) which represented so much of the principal and interest of the original loan made to the contractor as exceeded Twenty Thousand Five Hundred Dollars ($20,500.00), but petitioner refused to pay the Twenty Thousand Five Hundred Dollars ($20,500.00) for reasons which will presently appear, and the respondent then brought the present suit.

Prior to the suit the contractor received the final payment from the United States on the contract bonded by the petitioner (R. 122). From that payment the contractor paid the respondent, who had full knowledge of the source of said moneys, the sum of Twenty Thousand Five Hundred Dollars ($20,500.00) (R. 122, 133). The respondent, however, did not apply the said sum so received to the assigned bills for labor and materials referred to in the letter of guaranty, but took said payment for the discharge of an unsecured debt which the contractor owed the respondent on another and disconnected matter (R. 122, 130).

The petitioner defended against respondent's claim for said Twenty Thousand Five Hundred Dollars ($20,500.00) on the ground that the promises contained in said letter had been legally satisfied in their entirety and that the claims for labor and materials listed therein had been fully discharged and paid when the respondent received from the contractor the payment of the said sum of Twenty Thousand Five Hundred Dollars ($20,500.00).

Both courts below held in substance:

(1) That the matter in controversy was governed by New Jersey law and not federal law; that if there could be any doubt of the correctness of that conclusion as a general proposition, that doubt was settled in this case by the provision in the letter above mentioned providing "that the situs of this guaranty is New Jersey and shall be construed under the laws of said state". (R. 8.)

(2) That under the New Jersey law as construed by its highest court in the case of *Grover v. Board of Education of Township of Franklin,* 102 N. J. E. 415, 141 Atl. 81 (1928) aff. in 104 N. J. E. 197, 144 Atl. 918 (1929), the respondent was within its rights in applying the payment in the manner already described.

(Apparently neither court attached any significance to the fact that the legislature of New Jersey in 1932 and subsequent to the *Grover* case had enacted a statute which was specifically designed to change the rule of law for New Jersey which the *Grover* case had laid down. The said statute provides:

> "All money paid by the State of New Jersey or by any agency, commission or department thereof, or by any county, municipality, or school district in the state, to any person pursuant to the provisions of any contract for any public improvement made between any such person and the state or any agency, commission or department thereof, or any county, municipality or school district in the State, shall constitute a trust fund in the hands of such person as such contractor, until all claims for labor, materials and other charges incurred in connection with the performance of such contract shall have been fully paid." *R. S. New Jersey* 2:60-212 (1932).

(3) That if federal law governed the case the respondent would be compelled to apply the money received to the discharge of the debt for which petitioner would otherwise have been responsible.

The case was tried before the Honorable Phillip Forman without a jury (R. 1). The Trial Judge entered judgment in favor of the respondent and against the petitioner in the amount of Twenty Thousand Five Hundred Dollars ($20,500.00) (R. 136).[1]

An appeal was taken by the petitioner to the United States Circuit Court of Appeals for the Third Circuit from said judgment of $20,500.00. After argument before Circuit Judges Maris, Jones and Goodrich, the Court-below filed a decision affirming the judgment of the District Court (R. 154). The opinion was written by Circuit Judge Goodrich (R. 154-161). Subsequently, a petition for rehearing was presented to the United States Circuit Court of Appeals for the Third Circuit (R. 162-168), and on January 8, 1943, said petition for rehearing was denied (R. 169).

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered on December 4, 1942 (R. 161) and a petition for rehearing was denied January 8, 1943 (R. 169).

---

[1] The petitioner had counter-claimed for moneys which it alleged had been misapplied by respondent in payment of interest on an unsecured loan of the contractor and also sued the contractor and two of its officers as third party defendants (R. 11, 12, 120, 121). The Trial Judge dismissed petitioner's counter-claim but gave judgment for petitioner on its claims against said third party defendants (R. 135, 136). No appeal, however, has been taken from any of said judgments.

The jurisdiction of this Court to review said proceedings on a writ of certiorari is provided by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, § 1, 43 Stat. 928 (28 U. S. C. A. § 347 (a)).

OPINIONS.

An opinion was filed on March 10, 1942, by the Honorable Phillip Forman (R. 124). It is reported in 43 F. Supp. 596. The opinion of the United States Circuit Court of Appeals for the Third Circuit, written by Circuit Judge Goodrich, was filed on December 4, 1942 (R. 154), and is reported in 132 F. (2d) 114.

QUESTIONS PRESENTED.

1. Did not the Courts-below err in holding that the provision in petitioner's letter of guaranty, which places the situs in New Jersey for purposes of construction, makes New Jersey law govern, not only the extent of the obligation assumed by petitioner in said letter (which is admitted) but also the further and separate question, whether payment of the debt has in fact been made through a misapplication by respondent of federal funds contrary to the rights of petitioner as surety under the Hurd Act?

2. Since there is no contractual provision in the letter controlling the question, do not federal law and decisions govern the right of a creditor to apply federal funds received from a federal contractor, with knowledge of their source, in payment of a debt unrelated to the federal contract instead of applying them to the payment of unpaid labor and material bills in its hands incurred on the federal contract out of which the fund arose?

3. If federal law and decisions govern, is not petitioner entitled thereunder to a judgment?

4. Even if state law governs, is not petitioner nevertheless entitled to a judgment due to the fact that a legislative declaration of the law by that State, which was made after the court decision upon which the Courts-below relied and before the happening of any of the events out of which the instant case arose, changed the policy or the law of the state as announced by said court decision so that the present policy or law of the state compels a judgment for petitioner?

REASONS FOR GRANTING THE PETITION.

The United States Circuit Court of Appeals for the Third Circuit has misconstrued the letter of guaranty since there is nothing in that letter which even suggests that a question of payment or misapplication *vel non* would arise or, if it did arise, that those questions would be taken out of the orbit of federal decisions.

The petition should be granted because the United States Circuit Court of Appeals for the Third Circuit, in holding that the legal effect of the respondent's application of the contractor's money to claims foreign to the construction contract instead of to the assigned claims for labor and materials was governed by state and not federal law, has decided a federal question in conflict with applicable decisions of your Honorable Court. *Board of County Commissioners of the County of Jackson, Kansas v. United States,* 308 U. S. 343 (1939); *Deitrick, Receiver v. Greaney,* 309 U. S. 190 (1940); *Royal Indemnity Co. v. United States,* 313 U. S. 289 (1941); *D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation,* 315 U. S. 447 (1942), as well as in conflict with decisions of other Circuit Courts

of Appeals, *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.*, 112 F. (2d) 150 (C. C. A. 5th, 1940); *O'Brien v. Western Union Telegraph Co.*, 113 F. (2d) 539 (C. C. A. 1st, 1940).

The decision of the Court-below is likewise in conflict with decisions of the United States Circuit Courts of Appeals for the Fourth Circuit and for the Fifth Circuit, which hold that, under circumstances similar to those in this case, the surety is entitled to have the payment from the contractor applied to the debt for which it is bound. *United States v. Johnson, Smathers, & Rollins*, 67 F. (2d) 121 (C. C. A. 4th, 1933); *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.*, 112 F. (2d) 150 (C. C. A. 5th, 1940).

The Court-below has decided an important question of federal law not settled by your Honorable Court and in a way probably in conflict with applicable decisions of your Honorable Court concerning rights and liabilities of parties affected by the provisions of the Hurd Act, *supra*, *Martin v. National Surety Co.*, 300 U. S. 588 (1937); *Morley Construction Co. v. Maryland Casualty Co.*, 300 U. S. 185 (1937); *Walker v. Brown*, 165 U. S. 654 (1897); *Prairie State Bank v. United States*, 164 U. S. 227 (1896); *Henningsen v. United States Fidelity & Guaranty Co.*, 208 U. S. 404 (1908).

Finally, if the question of the application of the contractor's money be considered one of local law (which the petitioner does not concede), the decision of the Court-below is in conflict with the applicable local law as enacted by the legislature of the State of New Jersey, but as yet unannounced by the courts of said state. R. S. New Jersey 2:60-212 (1932).

The present controversy presents important questions of federal policy, of comity between state and federal

courts, of supremacy of federal decisions over state decisions in federal matters, and supremacy of legislative acts over prior state decisions. The decision of the Court-below does not adequately consider all of these questions but is based upon a misconception of the nature of the petitioner's defense and of the law applicable thereto, disregarding the decisions of other United States Circuit Courts of Appeals under the erroneous conclusion that state law alone was applicable and further misapplying the state law, after ruling that it was applicable.

The determination of the questions presented is of utmost importance, not only to the petitioner, but also to all contractors and their sureties, who have or will give bonds required under the Hurd Act, *supra*, or its successor, the Miller Act, *supra*. The duties, privileges, rights and obligations of parties affected by federal legislation which establishes a scheme of regulation such as that embraced in the Hurd Act, *supra*, and the Miller Act, *supra*, should be governed by uniform federal rules and should not be affected by the legal confusion, uncertainty and differences which would result if such parties' rights and obligations would be determined by the varying laws of the several states.

Respectfully submitted,

THE AETNA CASUALTY AND SURETY COMPANY,

By JOSEPH W. HENDERSON,
Of Counsel.

STATE OF PENNSYLVANIA,
COUNTY OF PHILADELPHIA, } *ss.:*

JOSEPH W. HENDERSON, being duly sworn according to law, deposes and says that he is counsel for the petitioner herein and that the facts set forth in the foregoing petition are true and correct to the best of his knowledge, information and belief.

JOSEPH W. HENDERSON.

Sworn to and subscribed before me this 1st day of April, A. D. 1943.

HARRISON G. KILDARE,
(Seal) *Notary Public.*
My Commission expires January 25, 1947.

I hereby certify that I have examined the foregoing petition and that in my opinion it is well founded and entitled to the favorable consideration of the Court and that it is not filed for the purpose of delay.

JOSEPH W. HENDERSON,
Counsel for Petitioner.

IN THE SUPREME COURT OF THE UNITED STATES.

No. . October Term, 1942.

The Aetna Casualty and Surety Company,
Petitioner,

v.

First Camden National Bank and Trust Company,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

For Opinions Below, Jurisdiction, Statement of the Case and Questions Presented, see pages 1 to 9 of the Petition.

SUMMARY OF ARGUMENT.

I. THE PROVISION IN PETITIONER'S LETTER OF GUARANTY PLACING THE SITUS IN NEW JERSEY FOR PURPOSES OF CONSTRUCTION DOES NOT CONSTITUTE AN AGREEMENT THAT NEW JERSEY LAW SHOULD GOVERN THE QUESTION WHETHER PETITIONER'S UNDERTAKING THEREUNDER HAD SUBSEQUENTLY BEEN PAID.

II. FEDERAL LAW GOVERNS THE RIGHT OF RESPONDENT TO APPLY FEDERAL FUNDS RECEIVED FROM FEDERAL CONTRACTOR, WITH KNOWLEDGE OF THEIR SOURCE, IN PAYMENT OF A DEBT UNRELATED TO THE FEDERAL CONTRACT INSTEAD OF APPLYING THE FUNDS TO THE PAYMENT OF BILLS FOR LABOR AND MATERIALS INCURRED ON THE FEDERAL CONTRACT.

III. UNDER FEDERAL LAW THE RESPONDENT WAS BOUND TO APPLY THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS COVERED IN THE LETTER OF GUARANTY AND NOT TO THE PAYMENT OF A DEBT UNRELATED TO IT.

IV. UNDER THE LAW OF THE STATE OF NEW JERSEY THE RESPONDENT WAS BOUND TO HAVE APPLIED THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS SPECIFIED IN THE LETTER OF GUARANTY.

Argument.

I. THE PROVISION IN PETITIONER'S LETTER OF GUARANTY PLACING THE SITUS IN NEW JERSEY FOR PURPOSES OF CONSTRUCTION DOES NOT CONSTITUTE AN AGREEMENT THAT NEW JERSEY LAW SHOULD GOVERN THE QUESTION WHETHER PETITIONER'S UNDERTAKING THEREUNDER HAD SUBSEQUENTLY BEEN PAID.

As an inducement to respondent to lend $29,912.36 to the contractor for the purpose of paying laborers and materialmen under Government contract, the petitioner, who was surety on contractor's bond required by the Hurd Act (36 Stat. 1167, 40 U. S. C. A. § 270) to cover that contract, guaranteed in writing to the respondent:—

1. That its bond was a valid obligation and that it was liable for the payment of stated bills for labor and materials; and

2. That if respondent took assignments of the aforesaid bills the petitioner would recognize each assignment and "pay the bill evidenced thereby, without interest, however, or so much thereof as remains unpaid at the expiration of six months subsequent to the final settlement of the foregoing construction contract at all event, not later than one year from February 23, 1937". (R. 6-8.)

The agreement further provided that "the situs of this guaranty is New Jersey and shall be construed under the laws of said state". (R. 8.)

The petitioner has always recognized its obligation thereunder, to wit, to pay the respondent within one year

the amount of said claims or so much thereof as then may not have been paid or discharged. However, petitioner has denied any liability to respondent for the sum of $20,500.00 on the ground that the claims which the petitioner guaranteed had been paid and discharged by respondent's receipt from the contractor of moneys which the respondent knew came from said construction contract notwithstanding its application by respondent to other claims foreign to the contract. This defense is not dependent upon the construction of the guaranty, for it does not arise out of the guaranty but out of matters which are separate and distinct therefrom and which occurred long after its execution. The defense is a plea of payment, but it is not rendered the less valid merely because the promise in the guaranty is absolute on its face.

The Courts-below have misconstrued the letter of guaranty in holding that the provision placing the situs in New Jersey for purposes of construction makes New Jersey law govern not only the extent of the obligation assumed by petitioner (which obligation has always been admitted) but also the petitioner's affirmative defense that the payment of the debt has in fact been made through a misapplication by respondent of funds from a federal contract contrary to the rights of petitioner.

There is nothing in the letter of guaranty which even suggests that the question of payment or misapplication *vel non* would arise, or if it did arise, that those questions would be taken out of the orbit of federal decisions.

The petitioner has always conceded that New Jersey law by virtue of the provision in its guaranty governs the construction and extent of its obligation. However, it has also consistently maintained that said provision is not ap-

plicable to petitioner's defense. The letter of guaranty offers no solution in any of its provisions as to whether federal or state law should be applied in determining the question whether payment has in fact been made in satisfaction of petitioner's undertaking. In fact, the letter in no way indicates that either the petitioner or the respondent considered either the possibility of that question arising or, if such a question were to arise, what law should govern.

See petitioner's Petition for Rehearing filed in the United States Circuit Court of Appeals for a further and more detailed discussion of this proposition. (R. 162, 163, 164.)

We, therefore, submit that the provision in the letter of guaranty placing the situs in New Jersey for purposes of construction has no application whatsoever to the questions involved in this proceeding, namely, has the debt for which petitioner is liable been paid and under what law is said question to be determined?

II. FEDERAL LAW GOVERNS THE RIGHT OF RESPONDENT TO APPLY FEDERAL FUNDS RECEIVED FROM FEDERAL CONTRACTOR, WITH KNOWLEDGE OF THEIR SOURCE, IN PAYMENT OF A DEBT UNRELATED TO THE FEDERAL CONTRACT INSTEAD OF APPLYING THE FUNDS TO THE PAYMENT OF BILLS FOR LABOR AND MATERIALS INCURRED ON THE FEDERAL CONTRACT.

It is well established that, where Congress has enacted legislation concerning a subject matter, all questions relating to the duties, privileges, and liabilities of the parties affected by that legislation must be governed by uniform

federal rules. ***Royal Indemnity Co. v. United States,*** 313 U. S. 289 (1941); ***Board of County Commissioners of the County of Jackson, Kansas v. United States,*** 308 U. S. 343 (1939); *Clearfield Trust Company v. United States,* — U. S. —, 63 Sup. Ct. 573 (decided March 1, 1943, but not officially reported); *Deitrick, Receiver, v. Greaney,* 309 U. S. 190 (1940); *R. P. Farnsworth & Co., Inc. v. Electrical Supply Co.,* 112 F. (2d) 150 (C. C. A. 5th, 1940); *O'Brien v. Western Union Telegraph Co.,* 113 F. (2d) 539 (C. C. A. 1st, 1940).

It is within the province of Congress, and not state legislatures or courts, to say upon what terms and conditions and in favor of what classes of persons federal funds are or cease to be chargeable with trusts, liens or equities, and, in the absence of specific provision in such legislation, "it is for the federal courts to fashion the governing rule of law according to their own standards". *Clearfield Trust Company v. United States, supra; Deitrick, Receiver, v. Greaney, supra; O'Brien v. Western Union Telegraph Co., supra.*

This case concerns the application of Government funds contrary to rights which became vested in the petitioner by virtue of the Hurd Act, *supra.* There is no question of the identity of the fund which the respondent received nor of the fact that the respondent "had knowledge of the source of payment which it applied to its general account" instead of to the payment of the assigned bills for labor and materials. (R. 133.) The petitioner's bond had been required under the Hurd Act, *supra,* and the petitioner's rights with respect to monies paid by the United States under the public work contract find their origin in the statutory regulation enacted by Congress. It, therefore, follows

—in the absence of a specific agreement to the contrary—that questions concerning the application of said funds and the rights of the contractor's surety must be determined by a uniform rule which can only be obtained through the federal decisions. "It would lead to great diversity in result by making identical transactions subject to the vagaries of the law of the several states. The desirability of a uniform law is plain." *Clearfield Trust Co. v. United States, supra.*

The Court-below erred in holding that the question in this case was not a federal one merely because suit had not been instituted on the petitioner's bond but on a letter of guaranty, and also because the federal court obtained jurisdiction on the ground of diversity of citizenship. Neither of these two facts constituted a justifiable reason for declining to apply federal law. *United States v. Clearfield Trust Co.*, 130 F. (2d) 93, 95 (C. C. A. 3rd, 1942). The right to sue on the petitioner's bond is but one of the provisions of the Hurd Act. Furthermore, we know of no decision in which your Honorable Court has ruled that federal law is not applicable in a proceeding because jurisdiction is based on diversity of citizenship. Since state courts, as well as federal courts, are bound by federal law as enacted by Congress, the fact that jurisdiction in this case is based on a diversity of citizenship has no bearing on the instant question.

If the rights and liabilities of the petitioner are not determined exclusively by federal law, the Congressional purposes expressed through the Hurd Act, *supra*, and its successor, the Miller Act, (49 Stat. 793; 40 U. S. C. A. § 270 a, b, c, and d) will be defeated, and the application of varying state rules of liability based solely on the law of the forum will destroy all uniformity.

The doctrine of *Erie Railroad Co. v. Tompkins*, 304 U. S. 64 (1938), "is inapplicable to the areas of judicial decision in which the policy of the law is so designated by the sweep of Federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law". *Sola Electric Co. v. Jefferson Electric Co.*, — U. S. —, 63 Sup. Ct. 172 (decided December 7, 1942, but not officially reported).

The Court-below, therefore, erred in refusing to apply federal law.

III. UNDER FEDERAL LAW THE RESPONDENT WAS BOUND TO APPLY THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS COVERED IN THE LETTER OF GUARANTY AND NOT TO THE PAYMENT OF A DEBT UNRELATED TO IT.

The United States Circuit Courts of Appeals for the Fourth Circuit and for the Fifth Circuit have uniformly held that under circumstances similar to those in this case, a surety is entitled to have payments from the contractor applied against the debt for which the surety is bound. *United States v. Johnson, Smathers, & Rollins*, 67 F. (2d) 121 (C. C. A. 4th, 1933); *R. P. Farnsworth and Co., Inc. v. Electrical Supply Company, supra.*

In *United States v. Johnson, Smathers, & Rollins, supra*, claim was made by a company which had furnished the subcontractor materials for use in a public works contract. The company, with knowledge that the moneys came from the public works project, nevertheless applied payments to another debt of the sub-contractor and then sued on the bond which had been required by the Hurd Act. The Court

held that the application was wrongful and that the surety was entitled to have the payment applied to the debt for which it was bound.

Similarly, in *R. P. Farnsworth and Co., Inc. v. Electrical Supply Company, supra,* materials had been furnished by an electrical supply company to a subcontractor who subsequently endeavored to apply moneys which said subcontractor received from a public works project to other items of its account with the subcontractor which were older and had no connection with the public work. The Court specifically held that the materialmen could not make such application to the prejudice of the principal and the surety on the bond.

Such holdings are consonant and in line with the decisions of your Honorable Court concerning the rights and liabilities of parties affected by the provisions of the Hurd Act, *supra,* as well as within the spirit of the Act. *Martin v. National Surety Co.,* 300 U. S. 588 (1937); *Morley Construction Co. v. Maryland Casualty Co.,* 300 U. S. 185 (1937); *Walker v. Brown,* 165 U. S. 654 (1897); *Prairie State Bank v. United States,* 164 U. S. 227 (1896); *Henningsen v. United States Fidelity and Guaranty Co.,* 208 U. S. 404 (1908).

The petitioner in this case is not seeking to recover for itself $20,500.00 which the respondent has misapplied, but desires and insists that the respondent properly apply the said money which, with knowledge of its source, namely, a federal contract, the respondent received from the contractor and which should have been applied to the labor and material bills covered by the letter of guaranty. Such application will not work to the prejudice of the respondent, but will merely place it in the same position which it would have

occupied if the moneys had been properly applied since it has neither parted with security nor placed itself in a different position without notice of the source of the funds, because the contractor's note to which the sum was applied was an unsecured obligation. See section III in petitioner's Petition for Rehearing filed in the United States Circuit Court of Appeals (R. 162, 167).

Thus, it is clear that under federal law the respondent was bound to have applied the $20,500.00 on account of the claims for labor and materials specified in the letter of guaranty and judgment should have been entered for the petitioner and against respondent.

IV. UNDER THE LAW OF THE STATE OF NEW JERSEY THE RESPONDENT WAS BOUND TO HAVE APPLIED THE $20,500.00 ON ACCOUNT OF THE CLAIMS FOR LABOR AND MATERIALS SPECIFIED IN THE LETTER OF GUARANTY.

If the question of the application of the contractor's money be considered one of local law (which the petitioner does not concede) the Court-below erred in ruling on the authority of *Grover v. Board of Education of Township of Franklin*, 102 N. J. E. 415, 141 Atl. 81 (1928), affirmed in 104 N. J. E. 197, 144 Atl. 918 (1929), that under local law the respondent, notwithstanding its knowledge of the source of the funds, could apply the same to an unsecured claim of the contractor. While it may be argued that the facts in the *Grover* case distinguish that case from the present case and that the specific problem in this controversy, therefore, is still undetermined by the courts of New Jersey, nevertheless, assuming that the *Grover* case is controlling, we submit that subsequent to that decision the law of that state

has been changed because in 1932 the legislature provided by statute that:—

> "All money paid by the State of New Jersey or by any agency, commission or department thereof, or by any county, municipality, or school district in the state, to any person pursuant to the provisions of any contract for any public improvement made between any such person and the state or any agency, commission or department thereof, or any county, municipality or school district in the State, shall constitute a trust fund in the hands of such person as such contractor, until all claims for labor, materials, and other charges incurred in connection with the performance of such contract shall have been fully paid." *R. S. New Jersey* 2:60-212 (1932).

While the legislature did not pretend to deal with federal funds (a matter over which it had no power to legislate, even if it had so attempted), the statute is as extensive and inclusive as the court's decision in the *Grover* case (which only concerned state funds) and so effectively overruled the law as enunciated in the *Grover* case that, if the same question were now to come before the New Jersey court, the decision would have to be different from the one handed down in the *Grover* case.

Since the law of New Jersey, as formerly enunciated by the *Grover* case, has thus been changed by legislative mandate and since state funds are specifically considered trust funds until all claims for labor and materials incurred in connection with a government contract have been fully paid, so has the law of New Jersey been changed with respect to federal funds, and they too must be considered trust funds until all claims for labor and materials have been fully paid. Thus the state legislature, supreme in de-

claring the law of its state concerning its own public works, has effectively changed the rule enunciated by the *Grover* case so far as concerns the federal public works, so far as it has been able so to do.

> "The appropriate way to read legislation in a situation like the one before us, was indicated by Mr. Justice Holmes on circuit: 'A statute may indicate or require as its justification a change in the policy of the law, although it expresses that change only in the specific cases most likely to occur in the mind. The Legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognized and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an adequate discharge of duty for the courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before.' *Johnson v. United States*, 163 F. 30, 32." *United States v. Hutcheson*, 312 U. S. 219, 235 (1941)

CONCLUSION.

We submit that the Court-below should have held that the letter of guaranty contained no agreement as to whether federal or state law was applicable in determining the legal effect of the respondent's application of the $20,500.00 to unsecured obligations of the contractor unrelated to the public works contract. Therefore, the Court-below should have applied federal law and held that under federal law the claims for labor and materials listed in the letter of guaranty were discharged when the respondent received the said sum of $20,500.00 from the contractor, with knowledge of its source, since it was bound to have applied said sum to

the payment of said claims; or assuming that local law was applicable, without admitting the same, the Court-below should have reached the same conclusion upon the ground that under the state law as enacted by the legislature of New Jersey but as yet unannounced by the courts of that state the petitioner is entitled to judgment.

We, therefore, submit that petitioner's prayer for a writ of certiorari should be granted.

Respectfully submitted,

JOSEPH W. HENDERSON,
Attorney for Petitioner,
Philadelphia, Pennsylvania,

April 1, 1943.

GEORGE M. BRODHEAD, JR.,
Of Counsel.